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PASS CEA FOR GREENSPAN, TREAS FOR BENNETT AND WIDMAN,
FRB FOR SOLOMON, COMMERCE FOR PATE

E.O.11652: N/A

TAGS: ECON, OECD

SUBJECT: EPC MEETING MARCH 6-7: INDIVIDUAL COUNTRY
VIEWS AND LATEST SECRETARIAT FORECASTS

REFS: (A) USOECD 6299

(B) USOECD 5463

(C) USOECD 3914

1. SUMMARY: THIS TELEGRAM SUPPLEMENTS GENERAL DIS-
CUSSION AND CONCLUSIONS OF ECONOMIC POLICY COMMITTEE IN
REF A, AND PROVIDES MORE DETAILED VIEWS OF U.S., GERMAN,
JAPAN AND BRITISH DELEGATES ON POLICY DEVELOPMENTS IN
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THEIR COUNTRIES. IT ALSO CONTAINS LATEST SECRETARIAT

REVISIONS OF FORECASTS FOR REAL GNP GROWTH, CONSUMER PRICES AND CURRENT ACCOUNT BALANCES FOR SEVEN MAJOR OECD COUNTRIES. SECRETARIAT FIGURES SHOW FURTHER REDUCTION IN REAL GNP GROWTH FORECASTS FOR MOST MAJOR OECD COUNTRIES (BUT NOT U.S.), WITH SLIGHTLY BETTER OUTLOOK FOR CONSUMER PRICES AND SLIGHTLY BETTER DISTRIBUTION OF CURRENT BALANCES. END SUMMARY.

2. U.S. ECONOMIC OUTLOOK: U.S. DEL (GREENSPAN) NOTED THAT U.S. ECONOMY HAS NOT QUITE HIT BOTTCM AND THAT MAIN FACTOR IN DOWNTREND IS STILL ACCELERATING INVENTORY ADJUSTMENT. REAL GNP THUS LIKELY TO FALL BY 10 PERCENT IN FIRST QUARTER OF 1975. PRICES NOW DEFINITELY DECLINING, HOWEVER, AND INFLATIONARY PATTERN MAY SOON BE BROKEN. UNEMPLOYMENT RATE STILL RISING, BUT LAYOFF RATE HAS PEAKED AND IS NOW DECLINING. RECOVERY OF ECONOMIC ACTIVITY CAN BE EXPECTED IN SECOND HALF OF YEAR.

3. U.S. POLICY OUTLOOK: U.S. FISCAL POLICY MAY TURN OUT TO CONTAIN \$10-20 BILLION MORE STIMULUS THAN EXPECTED DUE TO GREATER TAX CUTS AND EXPENDITURES BY CONGRESS AND LOWER GOVERNMENT TAX RECEIPTS DURING RECESSION. THIS, COMBINED WITH U.S. DEL'S BELIEF THAT EXCESSIVE FISCAL STIMULUS COULD HAVE COUNTERPRODUCTIVE IMPACT ON INFLATION, CAUSED SECRETARIAT TO CONCLUDE THAT U.S. HAS ALREADY REACHED LIMIT ON EXPANSIONARY MEASURES. HOWEVER, SINCE FISCAL STIMULUS WOULD BE LARGER THAN FORESEEN IN PRESIDENT'S MESSAGE, IT MIGHT LEAD TO FASTER RECOVERY IN SECOND HALF OF 1975 THAN EXPECTED BY SECRETARIAT. SECRETARIAT STILL UNCERTAIN IF DEGREE OF STIMULUS WOULD BE ENOUGH UNDER PRESENT CIRCUMSTANCES TO PRODUCE SUSTAINABLE RECOVERY. ON MONETARY SIDE, U.S. DEL (SOLOMON) NOTED THAT FRB TARGETS FOR MONETARY AGGREGATES HAD NOT BEEN ACHIEVED AND LARGE PART OF INTEREST RATE REDUCTION IN RECENT MONTHS WAS DUE TO DECLINING DEMAND FOR FUNDS. HE ALSO NOTED THAT RECENT DECLINE IN U.S. DOLLAR EXCHANGE RATE HAD INFLUENCED DOMESTIC MONETARY POLICY BECAUSE OF DESIRE NOT TO WIDEN INTEREST RATE DIFFERENTIAL, AND (IN RESPONSE TO QUESTIONS) THAT IT WOULD BE HELPFUL IF OTHER SURPLUS LIMITED OFFICIAL USE

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COUNTRIES COULD REDUCE THEIR INTEREST RATES. (GERMANY AND NETHERLANDS PROMPTLY NOTED THAT THEY HAD JUST REDUCED THEIR DISCOUNT RATES.)

4. GERMAN POLICY OUTLOOK: GERMANS BELIEVE THEIR ECONOMY MAY BE TURNING CORNER TOWARD RECOVERY, AND ARE HESITANT TO APPLY FURTHER STIMULUS UNTIL RESULTS CAN BE SEEN OF POLICIES ALREADY INTRODUCED. GERMAN DEL REJECTED SECRETARIAT PROPOSAL THAT GERMANY SHOULD EXPAND

FURTHER, AND SUPPORTED U.S. ON NEED TO LIMIT FISCAL
STIMULUS IF BUDGET DEFICIT IS TO AVOID REKINDLING INFLA-
TION. UK DEL SUGGESTED GERMANS CONSIDER RECOURSE TO
SHORT-TERM TREASURY BILL FINANCING SO AS TO AVOID COMPE-
TITION FOR FUNDS ON LONG-TERM BOND MARKET. SMALL
COUNTRIES GANGED UP IN DEMANDING MORE RAPID EXPANSION BY
GERMANY, AND MADE CLEAR THEIR VIEW THAT GERMAN CONCERNS
OVER INFLATION AT TIME OF "ONLY" 6 PERCENT ANNUAL
INCREASE IN PRICES WERE MISPLACED IN COMPARISON WITH

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NEGATIVE EFFECTS OF CAUTIOUS POLICIES ON TRADING PART-
NERS' EXTERNAL ACCOUNTS. GERMANS AGAIN PUBLICLY ACCEPTED
PRINCIPLE THAT SURPLUS COUNTRIES SHOULD BE FIRST TO

REFLATE, BUT STATED EMPHATICALLY THAT THEY WERE NOT PREPARED TO ADOPT FULL "GO" POLICY AT THIS TIME. HOWEVER, THEY WOULD REACT QUICKLY IF NEED BECAME CLEAR.

5. JAPAN POLICY OUTLOOK: JAPANESE EXPECT THAT ECONOMY WILL BOTTOM OUT IN FIRST HALF OF 1975 AS INVENTORY ADJUSTMENT WORKS ITSELF OUT AND CONSUMER DEMAND RECOVERS IN RESPONSE TO DECLINING PRICES. OUTLOOK FOR SPRING WAGE BARGAINING ROUND NOW MUCH IMPROVED, BUT JAPANESE NOT CONVINCED THAT INFLATIONARY PSYCHOLOGY HAS BEEN BROKEN. THEY INDICATED THAT MEASURES TO RESTIMULATE LIMITED OFFICIAL USE

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ECONOMY WERE ALREADY UNDERWAY, AND THAT CONTINUING PRICE DECLINES WOULD PROVIDE FURTHER FLEXIBILITY IN PURSUING DEMAND MANAGEMENT. EPC WAS VERY INTERESTED IN TIMING OF POLICY SHIFT, SINCE MEASURES WHICH ARE TAKEN AFTER COMPLETION OF WAGE ROUND MIGHT NOT HAVE MUCH IMPACT BEFORE END OF YEAR. JAPANESE ASSURED COMMITTEE THAT THEY HAD EXTENSIVE FISCAL MEASURES AVAILABLE TO THEM IN BUDGET NOW BEFORE PARLIAMENT, BUT THEY COULD NOT RISK TAKING VIGOROUS ANTI-INFLATIONARY MEASURES BEFORE WAGE ROUND OVER. THEY NOTED THAT SATISFACTORY SOFT LANDING AT LOWER LONG-TERM POTENTIAL GROWTH RATE OF 5-7 PERCENT (COMPARED WITH 10 PERCENT IN RECENT YEARS) REQUIRED THAT WAGE RATES BE HELD TO 15-17 PERCENT IN 1975. SECRETARIAT COMMENTED THAT FAILURE TO STIMULATE WOULD VERY LIKELY LEAD TO REAL GNP GROWTH DECLINING BY ONE PERCENT IN 1975.

6. UNITED KINGDOM POLICY OUTLOOK: UK DEL (WASS) PAINTED DISMAL OUTLOOK FOR UK ECONOMY, WITH OUTPUT STAGNANT, UNEMPLOYMENT RISING AND PRICES STILL NOT UNDER CONTROL. UK MADE PLEA TO SURPLUS COUNTRIES TO STOP WORRYING ABOUT RISKS OF STIMULUS ON THEIR ECONOMIES AND START REFLECTING ON VERY MUCH MORE SERIOUS DOMESTIC CONDITION OF DEFICIT COUNTRIES WHOSE MAIN HOPE LIES IN INCREASED EXPORTS. ONLY IF EXPORTS IMPROVE WOULD UK BE ABLE TO AVOID STIMULATING ITS OWN ECONOMY TO COUNTER RISING UNEMPLOYMENT. SECRETARIAT (FAY) COMMENTED THAT MAYBE UK SHOULD CONSIDER MORE RESTRICTIVE POLICIES AT TIME OF HIGH INFLATION, SINCE DEGREE OF RESTRAINT MUCH LESS IN UK THAN IN OTHER MAJOR COUNTRIES WHICH HAD BEEN WILLING TO PAY GREATER PRICE TO CONTROL INFLATION. OTHER COUNTRIES SUGGESTED THAT TIGHTER SOCIAL CONTRACT MIGHT BE DESIRABLE TO BOLSTER ANTI-INFLATION EFFORT.

7. IMPACT ON SMALL COUNTRIES: DELEGATES FROM SMALL COUNTRIES SHOWED UNACCUSTOMED RESTRAINT IN DISCUSSING THEIR OWN ECONOMIES, BUT MADE VERY CLEAR THEIR DESIRE FOR EARLY REFLATION BY LARGER COUNTRIES. NEW ZEALAND

NOTED THAT DIRECT CONTROLS OVER PRICES AND INCOMES WOULD
BE PREFERABLE FROM THEIR POINT OF VIEW BECAUSE THEY HAVE
LESS NEGATIVE IMPACT ON EXTERNAL TRADE THAN DEMAND
DEFLATION.
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8. FORECASTS OF REAL GNP GROWTH, CONSUMER PRICES AND
CURRENT BALANCES IN 1975: SECRETARIAT CIRCULATED LATEST
REVISIONS OF FORECASTS FOR MAJOR COUNTRIES AT EPC MEET-
ING. MAIN DIFFERENCES FROM FIGURES TRANSMITTED REFS B
AND C ARE THAT EXPECTED DECLINE IN REAL GNP GROWTH OUT-
LOOK FOR MAJOR SEVEN COUNTRIES IN 1975 HAS BEEN INCREASED
FROM 1.5 TO 2 PERCENT. MAIN CHANGE IS JAPAN, WITH GNP

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DECLINING 1 PERCENT INSTEAD OF RISING BY SAME AMOUNT (SEE PARA 5 ABOVE). SECRETARIAT SEES NO REASON TO CHANGE ITS FORECAST OF 4.5 PERCENT DECLINE IN GNP FOR U.S. PRICE FORECASTS SHOW SLIGHTLY LOWER RATE OF INCREASES IN INFLATION AS RESULT OF MORE OPTIMISTIC OUTLOOK FOR U.S., JAPAN AND UK (LATTER DUE TO EXPECTED LONGER PERIOD OF PHASEOUT OF SUBSIDIES TO NATIONALIZED INDUSTRIES). CURRENT ACCOUNT FORECASTS NOW SHOW SLIGHTLY SMALLER SURPLUS FOR GERMANY, AND marginally smaller deficits for FRANCE AND ITALY.

	GROWTH OF	INCREASE	CURRENT BALANCE
	REAL GNP (A)	IN CONSUMER PRICES	(\$ BILLION)

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		1974 TO	1974 Q4 TO	
		1975	1975 Q4	1975
CANADA	1	11.5	10.5	-5.5
U.S.	-4.5	9.5(B)	8 (B)	-2
JAPAN	-1	12	9	-2
FRANCE	2	12	10	-4
GERMANY	1	6	6	11.5
ITALY	-2	19.5	16	-4
U.K.	1	18.5	18.5	-7.5
TOTAL				
BIG 7	-2	11	9	-13.5

(A) GDP FOR FRANCE AND UK

(B) EXCLUDING POSSIBLE EFFECTS OF PRESIDENT'S ENERGY PROPOSALS. IF ENACTED IN FULL, THESE MIGHT ADD 1.5 PERCENT TO INCREASE BETWEEN 1974 AND 1975, AND 3 PERCENT BETWEEN 4TH QUARTERS OF 1974 AND 1975.

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